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Corporations—Corporation Bound by Collective Bargaining Agreement of Its Predecessor Partnership

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the express provisions of Section 61 of the General Corporation Law,[27] which was enacted to prevent the practice of buying into a corporation to commence suit on a pre-existing cause of action.[28]

D. G. M.

CORPORATION BOUND BY COLLECTIVE BARGAINING AGREEMENT OF ITS PREDECESSOR PARTNERSHIP

The case of *Reif v. Williams Sportswear, Inc.*[29] raised the issue of whether a corporation, in spite of the fiction of its separate legal existence, is bound by a collective bargaining agreement made by its predecessor (partnership) in the same business, when there has been no change in the persons controlling and owning the two businesses. The respondent corporation moved for a stay of the arbitration proceedings on the ground that its separate corporate existence insulated it from its predecessor's collective bargaining agreement under which the arbitration proceedings were being sought by the petitioner union. The motion was heard on the affidavits of both litigants.

The common law rule regarding a corporation's liability for a contract of its promoters is that the corporation cannot be bound by such a contract, since at the time the contract was entered into, the corporation was legally nonexistent and, therefore, could not be made a party to the contract by its promoters. Exceptions to this rule have been grounded upon several theories, including: ratification, adoption, estoppel and novation. Perhaps the most prevalent theory in New York State is that of implied adoption, which requires that the corporation, with knowledge of the contract, receive some benefit under it, and that the party rendering that benefit do so without knowledge of the new corporate identity acquired by the business.[30] Other jurisdictions have invoked the so-called "alter ego" doctrine[31] to find corporate liability in the special situation where a corporation and its predecessor have been controlled and owned by the same persons.[32]

In the present case the Court of Appeals did not decide the question of whether the respondent corporation had, by taking the benefit of union labor while knowing of the collective bargaining agreement, implicitly adopted the agreement. Part of the difficulty precluding the Court's consideration of this question was the insufficiency of the affidavits as to a finding concerning the

27. N.Y. Gen. Corp. Law § 61:
In any action brought by a shareholder in the right of a foreign or domestic corporation it must be made to appear that the plaintiff was a stockholder at the time of the transaction of which he complains or that his stock thereafter devolved him by operation of law.

28. Northridge Cooperative Section No. 1 v. 32nd Avenue Construction Corp., 2 N.Y.2d 514, 161 N.Y.S.2d 404 (1957).

29. 9 N.Y.2d 387, 214 N.Y.S.2d 395 (1961).

30. Morgan v. Bon Bon Co., 222 N.Y. 22, 118 N.E. 205 (1917). For a review of earlier cases see 1 White, New York Corporations 22 (12th ed. 1947).

31. For a thorough discussion of the "alter ego" doctrine, see. Schifferman, "Alter Ego," 32 Calif. S.B.J. 143 (1957).

32. See e.g., Zander v. Larsen, 41 Wash.2d 503, 250 P.2d 531 (1952); Fena v. Peppers Fruit Co., 185 Minn. 137, 239 N.W. 898 (1931).

union's knowledge or lack of knowledge of the respondent's incorporation. The Court, instead, relied on the "alter ego" doctrine for its disposition of the case, saying:

> A different concept of corporate liability may be invoked where the assets of a predecessor have been taken over completely in consideration of shares of stock, and no change has occurred in the underlying business. Several authorities support the position that, where the same men are doing business in the new guise of the corporation, and there are no stockholders who did not participate in the earlier enterprise, the corporation will be held liable for its predecessor's debts and contract obligations. . . .
>
> This corporation was as the Special Term put it, "an alter ego of the promoters."[33]

Thus, the Court held that the respondent was bound by its predecessor's collective bargaining agreement and would have to proceed to arbitration.

The "alter ego" doctrine has traditionally looked to two distinct elements in determining whether a corporation shall be bound by its predecessor's obligations. The first element is that there must be a close identity of ownership and control between the corporation and its predecessor. The second element is that some injustice would be promoted by upholding the fiction of the corporation's separate identity. The injustice element has been found in situations where an actual fraud, or an unjust enrichment, would be permitted by a decision in favor of the corporation. Likewise, instances where the individuals personally liable have fled the jurisdiction[34] or are judgment proof[35] have satisfied the injustice requirement.[36] In the present case the Court does not expressly point out the injustice avoided by holding the respondent corporation liable. Some suggestion of an unjust enrichment ("the corporation was able to get union labor it might not have enjoyed except for the collective bargaining agreement. . . .")[37] might be found, but the quoted language of the Court refers to the undecided question of implied adoption. Some suggestion of waiver of the corporation's right to object to the validity of the agreement by its participation in arbitration (taken up hereafter) might be found, except again as the Court says, "we need not, and do not, decide that question here."[38] Since this case has the aspect of a suit in equity for specific enforcement of arbitration, other would-be injustices present themselves. The union's remedy at law for damages might be inadequate, so that the union should not be lightly deprived of its equitable remedy. Here, however, the only dispute being submitted to arbitration was a disagreement over the amount of money the corporation owed to the union's pension fund. Possibly, the Court sitting as

33. Reif v. Williams Sportswear, Inc., supra note 29 at 389, 214 N.Y.S.2d at 399.
34. Zander v. Larsen, supra note 32.
35. Fena v. Peppers Fruit Co., supra note 32.
36. Supra note 31.
37. Reif v. Williams Sportswear, Inc., supra note 29 at 389, 214 N.Y.S.2d at 399.
38. Id. at 388, 214 N.Y.S.2d at 398.

a court of equity might have taken easy note of the questionable conduct of the corporation in regard to the contested agreement, since the corporation in effect admitted that it believed the agreement valid until, after having obtained one postponement of the arbitration proceeding, its attorney advised it that the agreement was invalid. Criticism of the "alter ego" doctrine has often been directed against its loose application where the courts have not been careful to find both elements of the doctrine present in a particular set of circumstances.[39] However, it appears in the present case that at least a slight showing of the injustice requirement can be discerned. Moreover, the respondent corporation could still raise any other defense it might have to the collective bargaining agreement, such as the union's alleged release of the agreement, in the arbitration proceeding itself. Thus, the corporation merely lost its defense based upon the fiction of its separate existence, where in actuality the corporation and its predecessor were the same parties who originally contracted with the union, and where these men by their questionable conduct made the preservation of that fiction at least a slight injustice.

In arriving at its decision, the Court passed over the arguments made concerning whether the corporation had, by its participation in the arbitration proceedings to the extent of appearing before the arbitrator and obtaining an adjournment, waived its right to object to the validity of the collective bargaining agreement under Sections 1458 and 1462 of the Civil Practice Act. The union analogized the corporation's appearance before the arbitrator to that of a general appearance in a civil suit by which the defendant loses his right to object to the court's jurisdiction. Although the Court expressed no opinion on the question of participation, the better guess as to the eventual decision of this question appears to be that the corporation had not participated to the extent required for waiver, as participation is explained in the leading case of *National Cash Register Co. v. Wilson.*[40]

D. P. S.

ELECTION NOT IN ACCORD WITH CORPORATE BY-LAWS HELD VOID

Petitioner brought an Article 78 proceeding[41] to have declared invalid both an amendment to the by-laws of respondent corporation increasing the number of its directors and the subsequent election of the new directors, as allegedly authorized by the amended by-law. The Court of Appeals, in *Sousa v. N.Y. State Knights of Columbus,*[42] reversed both the Special Term,[43] and the Appellate Division which had dismissed the petition.[44] In doing so, however, the Court declared the amendment itself valid, but held the election of directors

39. Supra note 31 at 144.
40. 8 N.Y.2d 377, 208 N.Y.S.2d 951 (1960).
41. N.Y. Civ. Prac. Act art. 78.
42. 10 N.Y.2d 68, 217 N.Y.S.2d 58 (1961).
43. 26 Misc. 2d 474, 203 N.Y.S.2d 3 (Sup. Ct. 1960).
44. 12 A.D.2d 956, 211 N.Y.S.2d 204 (2d Dep't 1961).